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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

No. 451

WALTER R. LAUDENSLAGER and MARGUERITE LAUDENSLAGER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FROM THE UNITED STATES COURT OF APPEALS IN THE THIRD CIRCUIT.

PETITION FOR WRIT OF CERTIORARI AND APPENDIX.

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INDEX.

	PAGE
Opinions below	1
Jurisdiction	2
Question Presented	2
Statutes Involved	2
Statement	3
Reasons for Granting the Writ	3
Conclusion	7
Appendix A	1a
Appendix B	13a

CITATIONS.

Cases:	PAGE
Barker v. *Commissioner*, 250 F. 2d 195	4, 5, 6
Bel v. *United States*, 160 F. Supp. 360	6
Crowell Land and Mineral Corp. v. *Commissioner*, 242 F. 2d 864	3, 5, 6
Commissioner v. *Remer*, 260 F. 2d 337	4, 5, 6
Commissioner v. *Southwest Exploration Co.* v. *Commissioner*, 350 U. S. 308	6
Dann, Robert M., 30 T. C. 499	6
Gowans v. *Commissioner*, 246 F. 2d 448	4, 5, 6
Green, Samuel L., 35 T. C. 1065	6
Griffith v. *United States*, 180 F. Supp. 454	6
Kirby Petroleum Co. v. *Commissioner*, 326 U. S. 599	6
Kittle, Otis A., 21 T. C. 70	6
Linehan v. *Commissioner*, 297 F. 2d 276	3, 4, 6
Olinger, Maude U., 27 T. C. 93	6

Statutes:

Internal Revenue Code of 1939:	
Section 117(a), (b) and (j)(1)	2, 13a
Section 117(j)(1)	2, 13a
Internal Revenue Code of 1954:	
Section 1202	2, 13a
Section 1221	2, 13a
Section 1231(a)	2, 13a

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vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FROM THE UNITED STATES COURT OF APPEALS IN THE THIRD CIRCUIT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

TO THE HONORABLE THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioners, Walter R. Laudenslager and Marguerite Laudenslager, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered in this case on June 27, 1962.

Opinions Below.

The opinion of the Tax Court (R. 14a-21a) is reported at 20 T. C. M. 336. The opinion of the Court of Appeals (Appendix A, *infra*, pp. 1a-11a) is not yet reported.

Jurisdiction.

The judgment of the Court of Appeals was entered on June 27, 1962 (Appendix A, *infra*, pp. 1a-11a). The jurisdiction of this Court is invoked under 28 U. S. C., section 1254.

Question Presented.

Taxpayer and Brewster entered into an agreement pursuant to which Brewster excavated fill material, comprising ordinary, sandy loam, from predetermined areas of taxpayer's property, and pursuant to which Brewster agreed to pay the taxpayer five cents per cubic yard of material extracted.

The following question is presented:

Whether the taxpayer's receipts are proceeds from the sale of capital assets and, hence, taxable as capital gain, or are payments taxable as ordinary income subject to depletion.

The Statutes Involved Are:

A. With respect to 1953:

Section 117 of the Internal Revenue Code of 1939, and particularly subsections (a), (b) and (j).

B. With respect to 1954:

Sections 1202, 1221 and 1231 (a) of the Internal Revenue Code of 1954.

The pertinent portions of the Statutes are set forth, at length, in Appendix B, *infra*, pp. 13a-14a.

Statement.

Petitioners are husband and wife. On their joint income tax returns for 1953 and 1954, they reported the proceeds from the transaction described below as capital gain income (R. 15a). On audit, the Commissioner of Internal Revenue, considered that such proceeds were taxable as ordinary income and asserted income tax deficiencies for both years.

In 1953 petitioners and George M. Brewster & Son, Inc. (Brewster), a road building contractor who required earth fill for a nearby construction job, entered into an agreement pursuant to which Brewster excavated and removed such earth fill from areas of petitioners property which the parties specifically delineated as to area and depth of excavation (R. 9a-13a), Brewster agreed to pay for the material so removed at the rate of five cents per cubic yard of material (R. 10a), and it is the amounts received by petitioners in accordance with Brewster's agreement which creates the issue.

The United States Tax Court, upon review, sustained the Commissioner's assertion of the deficiencies, 20 T. C. M. 336 (R. 20a-21a). The Court of Appeals affirmed the Tax Court. Both courts concluded that taxpayer's receipts were not proceeds of a "sale" and therefore were taxable as ordinary income (*infra*, p. 12a).

Reasons for Granting Writ.

1. The decision of the Court below is directly in conflict with the decision of the Court of Appeals for the First Circuit in *Linehan* v. *Commissioner*, 297 F. 2nd 276, as well as with the following decisions, in similar cases, by the Courts of Appeal for other Circuits as follows:

Crowell Land and Mineral Corp. v. *Commissioner*, 242 F. 2nd 864 (CA 5, 1957);

Gowans v. *Commissioner*, 246 F. 2nd 448 (CA 9, 1957);

Barker v. *Commissioner*, 250 F. 2nd 195 (CA 2, 1958);

Commissioner v. *Remer*, 260 F. 2nd 337 (CA 8, 1958).

In the *Linehan* case, and the other cases, the test which determined the tax treatment of transactions similar to that of the instant case was whether or not the taxpayer retained an economic interest in the material *after severance* from his property. In the instant case, however, the test formulated by the Court was whether or not the taxpayer retained an economic interest in the material *before severance* from his property.

Stating it another way, the Court below formulated the principle that the taxpayer has retained an economic interest, and therefore derives ordinary income, when title to the material does not pass before severance, even though compensation is at fixed unit prices (not dependent upon the value of the material or the extractor's use or profit); whereas the legal principle established in the other Circuits is that the taxpayer has retained no economic interest, and therefore derives capital gain income, because compensation is at fixed unit prices even though title does not pass before severance.

The conflict and its consequences are illustrated by a comparison of the instant case with *Linehan, supra,* with respect to which the Court below pointed out, "... the facts are not significantly different from those in the instant case ..." (Opinion, Note 4, Appendix A, p. 14a). In the instant case the Court below held[1] and in *Linehan* the fact was that

[1] The petitioner had argued that the amount of material to be taken was determined beforehand. If certiorari is granted the petitioner reserves the right to assert this contention.

the amount of material to be taken was not determined beforehand; and in both cases the price was set at a fixed rate per cubic yard of material extracted. In *Linehan* the Court held that because compensation was at a fixed price per cubic yard of material extracted (rather than for a percentage of the price received or the profits made on sale or use by exploiters), the taxpayer retained no economic interest after severance, consequently a sale occurred and the receipts from the transaction were capital gains. In the instant case, on the other hand, the Court held that the amount of material to be taken was not absolutely determined beforehand, therefore, even though compensation was at a fixed price per unit, the taxpayer had retained an economic interest because he had retained title up to the time of severance, consequently the receipts of the transaction were ordinary income. Thus, on practially identical facts, the two Courts of Appeal, applying different tests, reached conflicting decisions.

Similarly, the Courts of Appeal for the other Circuits have determined that a sale occurred, even though title remained in the taxpayer prior to severance when compensation depended upon the extractor's agreement to pay fixed price per unit of material extracted (*Crowell, Gowans, Barker* and *Remer, supra*).

The Court below commented that it saw no merit in the principle based on "fixed unit prices", and that other decisions (which include those hereinabove cited) are ". . . in conflict with the principles which we consider controlling" (Opinion, Note 4, Appendix A, p. 11a).

2. The question presented is of importance both to the general public which, regularly or occasionally, engages in any transactions similar to that of the instant case and to those who must administer the Federal tax laws. The

recurrence and importance of the question is shown by the large number of cases which have been passed upon by the Courts over the past years, including those already cited and others which were not reviewed on appeal.[2] Settlement of the question will prevent its further recurrence in future cases.

3. The decision of the Court below is believed to be erroneous, and the conflicting decisions[3] are believed to be correct. The economic interest test which has evolved from the interrelationship between the capital gains provisions and the depletion allowance provisions of the Internal Revenue laws (Opinion, Appendix A, pp. 6a-8a), has regularly been applied to fact situations similar to that of the instant case. In depletion cases it has been held that the taxpayer retained an economic interest when he has:

> (1) Acquired, by investment, any interest in the natural deposit in place; and
>
> (2) Secured by any legal relationship income derived from the extraction of the natural deposit to which he must look for return of his capital. *Gowans* v. *Commissioner*, 246 F. 2nd 448 citing *Commissioner* v. *Southwest Exploration Co.*, 350 U. S. 308, 314.

See also *Kirby Petroleum Co.* v. *Commissioner*, 326 U. S. 599.

In the instant case, and similar cases, there is no question with respect to the first element of the test because

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[2] *Robert M. Dann*, 30 T. C. 499, gov't appeal dismissed pursuant to stipulation, 4/14/59; *Samuel L. Green*, 35 T. C. 1065; *Otis A. Kittle*, 21 T. C. 79; *Maud U. Olinger*, 27 T. C. 93; *Griffith* v. *U. S.*, 180 F. Supp. 454; *Bel* v. *U. S.*, 160 F. Supp. 360.

[3] *Linehan* v. *Commissioner*, 297 F. 2d 276; *Crowell Land and Mineral Corp.* v. *Commissioner*, 242 F. 2d 864; *Gowans* v. *Commissioner*, 246 F. 2d 448; *Barker* v. *Commissioner*, 250 F. 2d 195; *Commissioner* v. *Remer*, 260 F. 2d 337.

the taxpayer owns the fee, although in depletion cases this element is the one which the Government usually asserts is absent. The second element of the test is absent in the instant case because the price is fixed at a unit rate, payable by Brewster whose personal covenant is the sole source for payment. When, as in the instant case, the taxpayer must look for compensation solely to the personal covenant of the exploiter he does not have an economic interest which gives rise to ordinary income subject to depletion. The court below, however, while adopting the rubric of the economic interest test has actually applied a novel formula, namely, a retention of title before severance test which takes into account only the first element of the two-fold test.

By substituting "retention of title before severance" for "retention of an economic interest", the court below has, in the name of the economic interest test, adopted a formula resulting in a decision which conflicts directly with those decisions based upon application of the established economic interest test to similar fact situations.

Conclusion.

For the foregoing reasons, this petition for writ of certiorari should be granted.

Respectfully submitted,

MORRIS J. OPPENHEIM,
Attorney for Petitioners.

September 1962.

APPENDIX A.

1. Opinion of the Court of Appeals.

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT.

No. 13,753.

WALTER R. LAUDENSLAGER and
MARGUERITE LAUDENSLAGER,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES.

Argued January 25, 1962.

Before KALODNER, STALEY and SMITH, Circuit Judges.

OPINION OF THE COURT.

(Filed June 27, 1962.)

By KALODNER, Circuit Judge.

This petition to review the decision of the Tax Court[1] presents the question whether amounts received by taxpayers under a contract for the excavation and removal of earth fill from their land constitute ordinary income, as the Tax Court held, or capital gain, as taxpayers contend.

The facts as found by the Tax Court are as follows:

On October 1, 1945, taxpayers, Walter R. Laudenslager and his wife Marguerite, purchased certain property in Middletown Township, Monmouth County, New Jersey, which they used as a residence and farm.

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[1] The Memorandum Findings of Fact and Opinion of the Tax Court are reported at 20 CCH Tax Ct. Mem. 384 (1961).

Appendix A.

In 1952 the New Jersey Highway Authority ("Authority") fixed and announced the alignment for a proposed limited access toll highway which cut across a section of taxpayers' property. A portion of their property was taken in condemnation by the Authority. Their remaining property was located approximately 300 to 400 feet from the Red Bank entrance to the new highway.

George M. Brewster & Son, Inc. ("Brewster"), a road building contractor, became the successful bidder for the contract to construct the section of the highway adjacent to taxpayers' property. Brewster's contract with the Authority provided that it would be its responsibility to acquire "borrow" material (fill dirt required for road construction) from an outside source at its own expense to complete the highway to its final grades and elevations. Brewster, prior to submitting its bid, had determined through tests that taxpayers' property could provide the requisite quantity and quality of earth fill, and had inquired of taxpayers whether it could buy either a section of their farm from which the fill could be obtained, or the fill itself. Taxpayers refused to sell any of their property but agreed to permit Brewster to buy fill from certain sections of it. On May 1, 1953, taxpayers and Brewster entered into an agreement which provided, in pertinent part, as follows:

> "WHEREAS, . . . [Brewster] desires to purchase from . . . [taxpayers] earth fill to be excavated from portions of the above described premises.
>
> "NOW THEREFORE, . . . [taxpayers] hereby . . . [agree] to permit . . . [Brewster], its agents and servants, to enter into and upon and leave from the the above described premises over existing roadways with all necessary equipment therefor, and to excavate and remove from the said premises earth fill or other material therefrom in conformity with and according to the Grading Plan approved and signed by both parties hereto . . . , and . . . [Brewster] agrees to complete the excavation and grading in

accordance with the aforesaid Grading Plan. It is agreed by both parties hereto that . . . [Brewster] will confine its grading operations within the limits as shown on the aforesaid Grading Plan. . . .

"Any material excavated and removed from the said property shall become the property of . . . [Brewster] according to the terms and conditions of this Agreement.

". . . [Brewster] agrees to pay unto . . . [taxpayers], the sum of Five Cents ($.05) per cubic yard for all material removed from said property. It is further understood and agreed between the parties hereto that a minimum quantity of 400,000 cubic yards is to be removed from said property and that this minimum quantity is based on the original borrow material requirements of 795,700 cubic yards as specified on the contract made between. . . . [Brewster] and the New Jersey Highway Authority-Garden State Parkway. . . .

"Notwithstanding the provisions herein with respect to the minimum quantities called for under this Agreement, it is expressly understood and agreed that should the New Jersey Highway Authority reduce the original borrow material requirements on the aforesaid contract, then and in that event the minimum quantities called for herein and the total amount payable hereunder will be reduced accordingly. It is agreed by and between the parties hereto that should the aforesaid minimum quantity be decreased or increased . . . [Brewster] will provide . . . [taxpayers] with a Revised Grading Plan, if requested by . . . [taxpayers], which Revised Grading Plan shall reflect the grades and appearances of the premises based upon such increase or decrease.

". . . [A]ll payments will be made on or about the 15th day of each month for material excavated,

removed and used in the performance of the aforesaid contract during the preceding month. . . .

". . . [Brewster] hereto advances to . . . [taxpayers] on account of this agreement, the sum of Five Thousand Dollars ($5,000.00) to be credited against payments due hereunder.

"The borrow material being purchased under this contract is required to meet specifications provided by the New Jersey Highway Authority. It is understood and agreed that . . . [Brewster] shall not be required to take or remove any material which does not meet such specifications and that if there shall not be sufficient quantities available which shall meet such specifications in the area involved in this contract, . . . [taxpayers] will allow . . . [Brewster] to enter into and acquire further areas within which to remove suitable borrow material. . . .

"It Is Agreed by and between the parties hereto that . . . [Brewster] will remove and stockpile outside of the adjacent grading limits all top soil from any part of said premises from which material is excavated and to respread all or part of top soil upon the graded area, at the termination of the operation if requested by . . . [taxpayers], for the sum of Twenty-five Hundred Dollars ($2,500.00), said sum to be deducted from payments due hereunder. . . ."

Attached to the May 1, 1953 agreement was a map of taxpayers' property showing the area from which Brewster was to remove earth fill and the depth of the excavation to be made in order that Brewster might obtain the 400,000 cubic yards specified in the agreement. As work on the highway progressed Brewster needed additional fill. Each time more fill was needed, Mr. Laudenslager and a representative of Brewster decided upon the area from which such material could be taken and they established an elevation down to which the material could be removed,

such elevation coinciding with and matching the elevation on an adjoining area from which material had already been taken. The excavation and removal operations, which took place during the period from July 1953 to August 1954, were performed by Brewster; taxpayers did not participate in the work. A total of 1,036,180 cubic yards of fill was taken from taxpayers' property, as follows:

Period	Cubic Yards Excavated and Removed
July, 1953	125,000
August, 1953	75,000
September, 1953	160,000
October, 1953	120,000
November, 1953	100,000
December, 1953	120,000
January 1, 1954 to August 2, 1954	336,180

The fill was ordinary, sandy loam, generally characteristic of the area in which taxpayers property was located and had no intrinsic value, by and of itself. It was the proximity of taxpayers' property to the section of the highway being constructed that made the property valuable as the source for obtaining fill required in the construction of the road. If Brewster had excavated more fill than it needed, it could not have sold it because there was no market for it.

Brewster complied with the provisions of the May 1, 1953 agreement requiring it to remove and stockpile the topsoil before excavating the fill. At taxpayers' request, and in accordance with the agreement, Brewster respread the topsoil when the work of excavation had been completed. The area that was excavated had previously been used by taxpayers for growing farm crops. After the excavation of the fill and the respreading of the topsoil, the area would have required several years of rehabilitation to regain its original productive quality.

Appendix A.

The coming of the highway made taxpayers' property desirable for housing development. Taxpayers had decided to sell the property for such purposes prior to the transaction with Brewster; and by agreement dated January 27, 1954, as modified by supplemental agreements dated April 14, 1954 and May 20, 1954, they sold all of the property except the buildings and land surrounding the buildings which they reserved for themselves. The usefulness of the property for housing development purposes was neither impaired nor enhanced by the removal of the fill.

Taxpayers were not engaged in the business of buying and selling real estate. Except for the transaction with Brewster, they never sold or excavated any dirt, earth or other material from their property.

Brewster made the following payments to taxpayers pursuant to the agreement for the excavation and removal of the fill:

Date of Payment		Amount
May 12, 1953		$5,000.00
August 11, 1953		1,250.00
September 16, 1953		3,750.00
October 13, 1953		8,000.00
November 11, 1953		6,000.00
December 12, 1953		5,000.00
January 16, 1954		6,000.00
October 27, 1954	$16,809.00	
Less: charges for respreading topsoil	2,500.00	14,309.00
TOTAL		$49,309.00

The Tax Court held that these payments were taxable as ordinary income to taxpayers for the years 1953 and 1954.

The Supreme Court long ago set forth the basic principles applicable to the taxation of receipts from the extraction of natural deposits. In Burnet v. Harmel, 287 U. S. 103 (1932), a taxpayer, the owner in fee of certain oil

lands, had executed oil and gas leases of the lands in return for cash bonus payments and for royalties measured by the production of oil and gas by the lessee. In declaring that the bonus payments and royalties were taxable as ordinary income rather than as gain from a sale of capital assets, Mr. Justice Stone stated (p. 107):

> "... [T]he statute speaks of a 'sale,' and these leases would not generally be described as a 'sale' of the mineral content of the soil, using the term either in its technical sense or as it is commonly understood. Nor would the payments made by lessee to lessor generally be denominated the purchase price of the oil and gas. By virtue of the lease, the lessee acquires the privilege of exploiting the land for the production of oil and gas for a prescribed period; he may explore, drill, and produce oil and gas if found. Such operations with respect to a mine have been said to resemble a manufacturing business carried on by the use of the soil, to which the passing of title of the minerals is but an incident, rather than a sale of the land or of any interest in it or its mineral content. *Stratton's Independence v. Howbert*, 231 U. S. 399, 414, 415; see *Von Baumbach v. Sargent Land Co.*, 242 U. S. 503, 521."

Although in *Harmel* the receipts were held to be ordinary income, that case does not hold that a transaction involving the extraction of natural deposits from the land of another can never give rise to capital gain. The test for determining whether the proceeds of a given transaction constitute ordinary income or capital gain is known as the "economic interest" test and has evolved from the interrelationship between the capital gains provisions of the revenue laws and the provisions authorizing depletion allowance. Where the owner of the land retains an economic interest in the deposits, the transaction is regarded as a lease and the proceeds are taxable as ordinary income,

subject, under certain conditions, to a deduction for depletion. Conversely, where the owner does not retain an economic interest, the transaction is regarded as a sale and, assuming that the transaction otherwise qualifies for capital gain treatment, the proceeds are taxable as capital gain. The owner has retained an economic interest if he has acquired, by investment, any interest in the natural deposit in place, and has secured, by any form of legal relationship, income derived from the extraction of the deposit, to which he must look for a return of his capital. The determination of whether an economic interest has been retained is not dependent upon the label that is given to the transaction by the parties or by the local law, nor is it dependent upon the owner's retention of title or any other particular form of legal interest in the deposit. Palmer v. Bender, 287 U. S. 551 (1933); Gowans v. Commissioner, 246 F. 2d 448 (9 Cir. 1957); 4 Mertens, Federal Income Taxation § 24.57 (1960).

By way of illustrating these principles, a transaction is not considered a sale where, for example, the transferor reserves a royalty of a percentage of the minerals to be produced, or where, in addition to reserving a royalty, he receives a cash bonus payment. Burnet v. Harmel, *supra*. Similarly, a sale does not occur where the transferor retains a right to royalty payments of stated amounts per unit mined and sold with a provision for minimum payments, Bankers Pocahontas Coal Co. v. Burnet, 287 U. S. 308 (1932), affirming 55 F. 2d 626 (4 Cir. 1932), or a right to a share of the net profits from production, Burton-Sutton Oil Co. v. Commissioner, 328 U. S. 25 (1946), or where he receives a contemporaneous cash payment plus a right to a deferred payment of a specified sum of money payable solely from production, Thomas v. Perkins, 301 U. S. 655 (1937). On the other hand, a transaction is regarded as a sale where, for example, payments can be made from future sales of the fee interest as well as from production, or where the transferee personally guarantees

that an oil payment will equal the specified sum. See Anderson v. Helvering, 310 U. S. 404, 412-13 (1940).

In the instant case the transaction between taxpayers and Brewster was simply an arrangement whereby Brewster was granted the right to excavate and remove earth fill in return for a royalty of a specified sum per unit of material taken. Under the principles stated this was not a sale within the meaning of the capital gains provisions.

Taxpayers make much of the designation of specific "cross-sections" of land from which the fill was to be excavated and of the provision purporting to require Brewster to excavate the initial cross-section containing 400,000 cubic yards of fill. We think taxpayers' reliance on these factors is misplaced for these reasons:

First: The requirement that Brewster take a minimum quantity of 400,000 cubic yards was subject to two important qualifications: (1) a reduction in Brewster's requirements under its contract with the New Jersey Highway Authority would reduce the minimum quantity accordingly, and, (2) Brewster was not required to take any material which did not meet the specifications of the Authority; thus the payments to taxpayers were dependent upon the actions and needs of the New Jersey Highway Authority.

Second: Even assuming that the contract imposed an absolute obligation upon Brewster to take a minimum of 400,000 cubic yards, the result would be analogous to a provision for minimum royalties or bonus payments and such a provision would not convert the transaction into a sale. See Bankers Pocahontas Coal Co. v. Burnet, *supra;* Burnet v. Harmel, *supra;* Otis A. Kittle, 21 T.C. 79, 87-88 (1953), aff'd, 229 F.2d 313 (9 Cir. 1956). The fact that the 400,000 cubic yards minimum was to be obtained from a specifically designated cross-section rather than from the land as a whole has no significance. Further, insofar as the presence or absence of an economic interest is concerned, neither the designation of a specific area from which the

fill was to be taken, nor taxpayers' characterization of the transaction as a "sale of a cross-section of the land,"[2] nor the use of the word "purchase" in the agreement between taxpayers and Brewster can serve to alter the hard realities of the situation. To rely on such factors would be to place form over substance.

In cases of this type "The facts of each transaction must be appraised to determine whether the transferor has made an absolute sale or has retained an economic interest . . ."[3]

The sum total of the factual situation in the instant case is this: taxpayers owned land on which there was earth fill; they granted Brewster a contractual right to extract and remove some of it at a fixed unit price; Brewster did not contract to extract and remove *all* of the earth fill on taxpayers' property nor did it contract to extract and remove an absolute, inflexible *minimum* of the fill; and finally, the contract provided that Brewster was not required "to take or remove any material" which did not meet specifications of the Authority.

The legal result of this factual situation is this: there was no *sale* of the earth fill *in place;* taxpayers retained their economic interest in the earth fill prior to extraction; the payments made by Brewster for the extracted and removed fill, as the extractions and removals occurred, constituted ordinary income.

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[2] The quoted phrase is from taxpayers' brief.

[3] Kirby Petroleum Co. v. Commissioner, 326 U. S. 599, 606 (1946).

Appendix A.

For the reasons stated the decision of the Tax Court will be affirmed.[4]

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

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[4] Taxpayers have cited several decisions from other Circuits. In two of them, Crowell Land and Mineral Corp. v. Commissioner, 242 F. 2d 864 (5 Cir. 1957), and Linehan v. Commissioner, 297 F. 2d 276 (1 Cir. 1961), the facts are not significantly different from those in the instant case; yet the courts there ruled in favor of capital gain treatment, relying primarily on factors which, in our opinion, do not warrant the significance that was attributed to them and accordingly we disagree with their holdings. In *Crowell*, stress was laid on the circumstance that the agreement was labelled "Contract of Sale" and contained such words as "vendor", "vendee", "sold and conveyed", and "full warranty of title"; and in both cases emphasis was placed on the fact that payments were based on fixed prices per unit of material taken rather than on resale price or market price. We have already pointed out the lack of significance of the descriptive terminology used by the parties. Neither do we see any merit in the distinction based on fixed unit prices. Bankers Pocahontas Coal Co. v. Burnet, 287 U. S. 308 (1932), affirming 55 F. 2d 626 (4 Cir. 1932); Otis A. Kittle, 21 T. C. 79 (1953), aff'd, 229 F. 2d 313 (9 Cir. 1956); Robert M. Dann, 30 T. C. 499, 509 (dissenting opinion); see Thomas v. Perkins, 301 U. S. 655 (1937).

Other cases cited by taxpayers are either distinguishable on their facts from the instant case or in conflict with the principles that we consider controlling. Further, we note that Gowans v. Commissioner, 246 F. 2d 448 (9 Cir. 1957), relied on by taxpayers, actually supports the Commissioner here. In holding the proceeds from the removal of sand from the taxpayers' property to be a capital gain, the court there laid great stress on the fact that the contract imposed an absolute obligation "to remove all of the sand" from the taxpayers' property.

Appendix A.

2. Judgment of the Court of Appeals.

ON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES.

Present:

KALODNER, STALEY and SMITH, Circuit Judges.

JUDGMENT.

This cause came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed.

Attest:
IDA O. CRESKOFF,
Clerk.

June 27, 1962

APPENDIX B.

The Statutes Involved Are:

The pertinent portions of the Statutes are:

INTERNAL REVENUE CODE OF 1939.

SECTION 117 (a) (1) * * * the term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), * * *

SECTION 117 (b)—*Deduction from Gross Income:* In the case of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50% of the amount of such excess shall be a deduction from gross income * * *

SECTION 117 (j) (1)—For the purpose of this subsection the term "property used in the trade of business" means * * * and real property used in the trade or business, held for more than six months * * *

INTERNAL REVENUE CODE OF 1954.

SECTION 1202: *Deduction for Capital Gains*—In the case of a taxpayer, other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50% of the amount of such excess shall be a deduction from gross income * * *

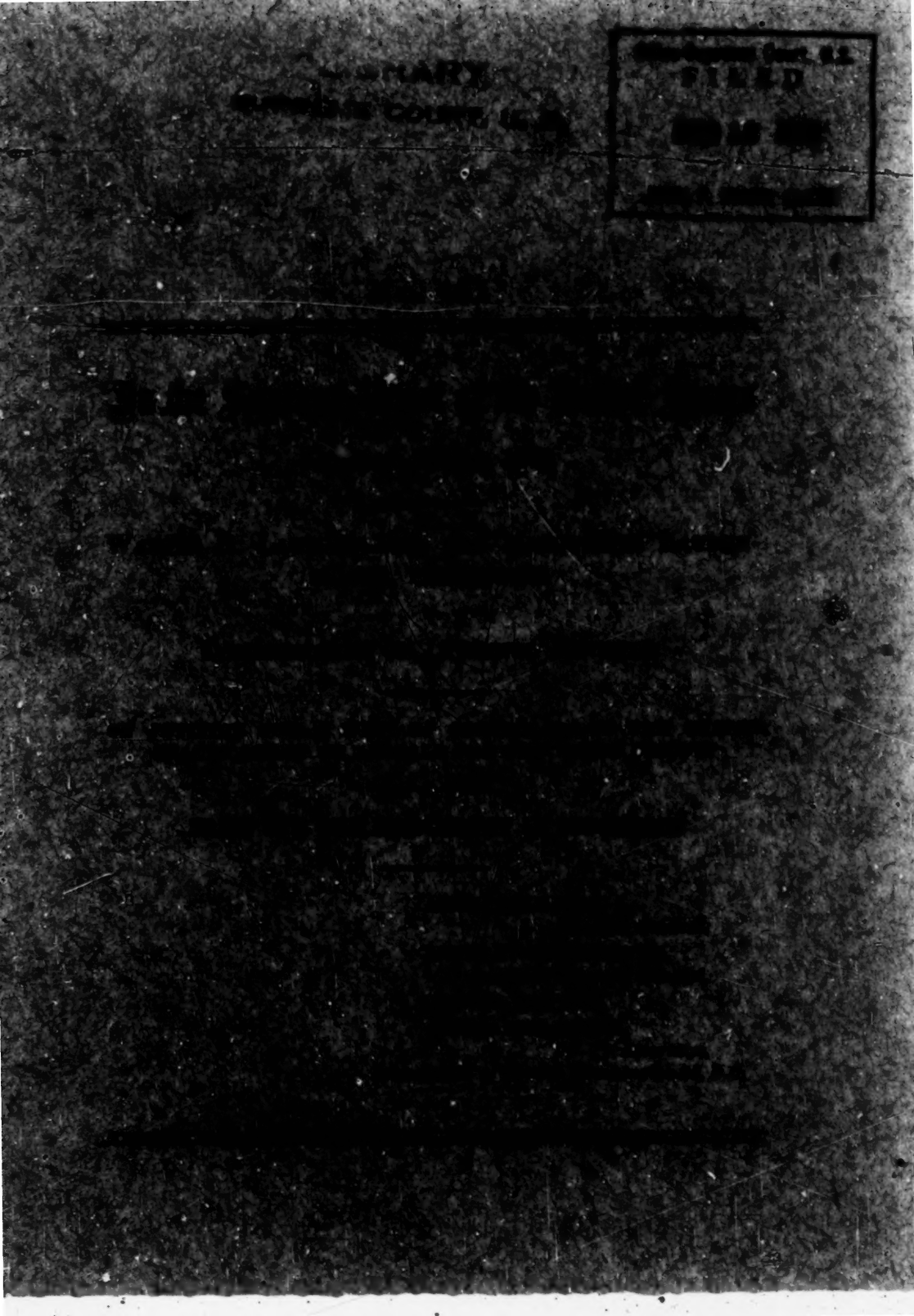
SECTION 1221: *Capital Asset Defined.* For the purposes of this sub-title, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business).

SECTION 1231: (a) *General Rule.* If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, * * * such gains and losses shall be considered as gains and losses from the sales or exchanges of capital assets held for more than six months * * *

Appendix B.

(b) *Definition of Property used in the trade or business*—For purposes of this section:

(1) *General Rule*—The term "property used in the trade or business" means * * * and real property used in the trade or business, held for more than 6 months.



INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statement	2
Argument	8
Conclusion	13

CITATIONS

Cases:

Albritton v. *Commissioner of Internal Revenue*, 248 F. 2d 49	9
Anderson v. *Helvering*, 310 U.S. 404	8
Barker v. *Commissioner of Internal Revenue*, 250 F. 2d 195	8, 10
Burnet v. *Harmel*, 287 U.S. 103	8
Burton-Sutton Oil Co. v. *Commissioner*, 328 U.S. 25	8
Commissioner v. *Southwest Expl. Co.*, 350 U.S. 308	8
Crowell Land & Mineral Corp. v. *Commissioner of Internal Revenue*, 242 F. 2d 864	10, 11
Dann v. *Commissioner*, 30 T.C. 499	8, 12
Gowans v. *Commissioner of Internal Revenue*, 246 F. 2d 448	8, 10, 11
Green v. *Commissioner*, 35 T.C. 1065	9
Kirby Petroleum Co. v. *Commissioner*, 326 U.S. 599	8
Linehan v. *Commissioner of Internal Revenue*, 297 F. 2d 276	11, 12, 13

Cases—Continued Page
Palmer v. *Bender*, 287 U.S. 551 8
Parsons v. *Smith*, 359 U.S. 215 8
Stratton's Independence v. *Howbert*, 231 U.S. 399 8
Thomas v. *Perkins*, 301 U.S. 655 8
Statute:
26 U.S.C. 613 12

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 451

WALTER R. LAUDENSLAGER AND MARGUERITE LAUDENSLAGER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion (R. 14a–21a)[1] of the Tax Court are not officially reported. The opinion of the court of appeals (Pet. 1a–11a) is reported at 305 F. 2d 686.

JURISDICTION

The judgment of the court of appeals was entered on June 27, 1962 (Pet. 12a). The petition for a writ of certiorari was filed on September 21, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

[1] Record references are to the separately bound appendix to taxpayers' brief in the court of appeals.

QUESTION PRESENTED

The taxpayers entered into an agreement under which they gave a road contractor the right to remove fill dirt from their land for five cents a cubic yard. The question presented is whether the court below erred in holding that the amount received by the taxpayers for the dirt was taxable as ordinary income, rather than as capital gain.

STATEMENT

The relevant facts as found by the Tax Court (R. 15a–20a), and adopted by the court below (Pet. 1a), are as follows:

The taxpayers, Walter R. and Marguerite Laudenslager, are husband and wife. On October 1, 1945, they purchased certain lands located in Middletown Township, Monmouth County, New Jersey, together with the buildings located on them. They used the property as a residence and farm (R. 15a).

In 1952 the New Jersey Parkway Authority fixed and announced the alignment for a proposed limited access, toll highway which cut across a section of the taxpayers' property. A portion of their property was taken in condemnation by the Authority and the highway was thereafter constructed. The taxpayers' remaining property was located approximately 300 to 400 feet from the Red Bank entrance to the new highway. The contemplated construction of the highway made the area desirable for a housing development and the taxpayers' property, because of its proximity to the highway, became particularly desirable for such purposes. Real estate agents seek-

ing to interest the taxpayers in selling their property approached them even before the alignment of the new highway became definitely established (R. 15a).

George. M. Brewster & Son, Inc. (hereinafter referred to as Brewster), a road building contractor, became the successful bidder for the contract to construct the sections of the highway adjacent to the taxpayers' property. Brewster's contract with the New Jersey Highway Authority provided that it would be the responsibility of the contractor to acquire the fill required for road construction from an outside source at its own expense to complete the parkway to its final grades and elevations. Brewster, prior to submitting its bid, had determined through tests that the taxpayers' property could provide the requisite quantity and quality of earth fill. Brewster approached the taxpayers, through Emerson Branham, Brewster's resident manager, to inquire whether it could buy from them property from which the fill could be obtained, or could buy the fill itself. The taxpayers refused to sell any of their property, but agreed to permit Brewster to buy fill from certain sections of their property (R. 15a–16a). On May 1, 1953, an agreement was entered into between the taxpayers and Brewster which provided in part, as follows (Ex. 3-C; R. 9a–12a):

> WHEREAS, [Brewster] desires to purchase from the [taxpayers] earth fill to be excavated from portions of the above described premises.
>
> NOW THEREFORE, the [taxpayers] * * * hereby agree to permit [Brewster], its agents

and servants, to enter into and upon and leave from the above described premises over existing roadways with all necessary equipment therefor, and to excavate and remove from the said premises earth fill or other material therefrom in conformity with and according to the Grading Plan approved and signed by both parties hereto * * *, and [Brewster] agrees to complete the excavation and grading in accordance with the aforesaid grading Plan. * * *

Any material excavated and removed from the said property shall become the property of [Brewster] * * *.

[Brewster] agrees to pay unto the [taxpayers], the sum of Five Cents ($.05) per cubic yard for all material removed from said property. It is further understood and agreed between the parties hereto that a minimum quantity of 400,000 cubic yards is to be removed from said property and that this minimum quantity is based on the original borrow material requirements of 795,700 cubic yards as specified on the contract made between [Brewster] and the New Jersey Highway Authority-Garden State Parkway * * *.

Notwithstanding the provisions herein with respect to the minimum quantities called for under this Agreement, it is expressly understood and agreed that should the New Jersey Highway Authority reduce the original borrow material requirements on the aforesaid contract, then and in that event the minimum quantities called for herein and the total amount payable hereunder will be reduced accordingly. It is agreed by and be-

tween the parties hereto that should the aforesaid minimum quantity be decreased or increased [Brewster] will provide the [taxpayers] with a Revised Grading Plan, if requested by the [taxpayers], which Revised Grading Plan shall reflect the grades and appearances of the premises based upon such increase or decrease.

* * * all payments will be made on or about the 15th day of each month for material excavated, removed and used in the performance of the aforesaid contract during the preceding month. * * *

[Brewster] hereto advances to the [taxpayers] on account of this agreement, the sum of Five Thousand Dollars ($5,000.00) to be credited against payments due hereunder.

The borrow material being purchased under this contract is required to meet specifications provided by the New Jersey Highway Authority. It is understood and agreed that [Brewster] shall not be required to take or remove any material which does not meet such specifications and that if there shall not be sufficient quantities available which shall meet such specifications in the area involved in this contract, the [taxpayers] will allow [Brewster] to enter into and acquire further areas within which to remove suitable borrow material * * *.

It Is Agreed by and between the parties hereto that [Brewster] will remove and stockpile outside of the adjacent grading limits all top soil from any part of said premises from which material is excavated and to respread

> all or part of top soil upon the graded area, at the termination of the operation if requested by the [the taxpayers] for the sum of Twenty-five Hundred Dollars ($2,500.00) said sum to be deducted from payments due hereunder. * * *.

Attached to the May 1, 1953, agreement is a map of the taxpayers' property showing the area from which Brewster was to remove earth fill and the depth of the excavation to be made in order that Brewster might obtain the 400,000 cubic yards of fill which it originally estimated would meet its requirements. As work on the highway progressed, Brewster needed more fill than was originally estimated. The total quantity ultimately taken from the taxpayers' property, during the period from July 1953 to August 1954, was in excess of 1,000,000 cubic yards. Each time Brewster needed additional material, the taxpayer and Brewster's chief engineer went to the taxpayers' property, decided upon the area from which such material could be taken, and established an elevation down to which the material could be removed that would coincide with and match the elevation on an adjoining area from which material had already been taken. Brewster complied with the provisions of the May 1, 1953, agreement requiring it to remove and stockpile the topsoil before excavating the fill. At the taxpayers' request and in accordance with the agreement, Brewster respread the topsoil when the work of excavation had been completed, and the taxpayers paid Brewster the agreed price (R. 18a–19a).

The fill was ordinary, sandy loam, generally characteristic of the area in which the taxpayers' property was located and had no intrinsic value, by and of itself. It was the proximity of the taxpayers' property to the section of the roadway being constructed that made the property valuable as the source for obtaining fill required in the construction of the road. If Brewster had excavated more fill than it needed, it could not have sold it because there was no market for it. The taxpayers did not participate in the work of excavating the fill and did not share in any profit or income derived by Brewster from the use of the fill in the construction of the highway (R. 19a).

The area that Brewster had excavated had been used by the taxpayers for growing farm crops. After the excavation of the fill and respreading of the topsoil, the area would have required several years of rehabilitation before it could be used for growing crops. The usefulness of the taxpayers' property for housing development purposes, however, was neither impaired nor enhanced by the removal of the fill. Under an agreement dated January 27, 1954, the taxpayers sold the property, except for the buildings and land surrounding them, in accord with their intent prior to entering into the contract with Brewster (R. 19a–20a).

The Commissioner determined that the $49,309 received by the taxpayers in 1953 and 1954 from Brewster was taxable as ordinary income (R. 20a). The Tax Court (R. 21a) and the court of appeals (Pet. 1a–11a) upheld that determination.

ARGUMENT

1. Notwithstanding taxpayers' assertions (Pet. 4, 5, 7), the court of appeals formulated no novel legal test in taxing as ordinary income the amounts received by taxpayers under a contract for the excavation and removal of earth fill from their property. On the contrary, the court below applied the established rules of law to determine whether there had been a sale of capital assets resulting in capital gain or an "exploitation" of natural deposits, producing, like any other business, ordinary income. The courts, consistent with the principles laid down by this Court,[2] have distinguished two situations: (1) when mineral "in place," has been sold outright with no retention by the vendor of ownership or other "economic interest" in the deposits, the proceeds constitute capital gain (*Barker* v. *Commissioner of Internal Revenue*, 250 F. 2d 193 (C.A. 2); *Gowans* v. *Commissioner of Internal Revenue*, 246 F. 2d 448 (C.A. 9); *Dann* v. *Commissioner*, 30 T.C. 499); and (2) when the parties have made an arrangement to sell the mineral at a unit price from time to time as it is extracted from the property, the owner retaining

[2] *Stratton's Independence* v. *Howbert*, 231 U.S. 399; *Burnet* v. *Harmel*, 287 U.S. 103; *Palmer* v. *Bender*, 287 U.S. 551; *Anderson* v. *Helvering*, 310 U.S. 404; *Thomas* v. *Perkins*, 301 U.S. 655; *Kirby Petroleum Co.* v. *Commissioner*, 326 U.S. 599; *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U.S. 25; *Commissioner* v. *Southwest Expl. Co.*, 350 U.S. 308; *Parsons* v. *Smith*, 359 U.S. 215.

an "economic interest" in the deposits until physically removed, the payments are ordinary income (*Albritton v. Commissioner of Internal Revenue*, 248 F. 2d 49 (C.A. 5); *Green v. Commissioner*, 35 T.C. 1065).

2. The court below found that "the transaction between taxpayers and Brewster was simply an arrangement whereby Brewster was granted the right to excavate and remove earth fill in return for a royalty of a specified sum per unit of material taken" (Pet. App. 9a). Consequently, it concluded that the transaction did not constitute a sale "in place" of the earth fill; that, since the material was sold only as it was extracted and removed, taxpayers retained an "economic interest" in the fill prior to extraction; and that therefore the amounts received were properly taxable as ordinary income.

This conclusion is amply supported by the contract provisions. No fee interest was conveyed, since the agreement expressly stipulated that only dirt actually "excavated and removed" from the land became the property of Brewster, and monthly payments were based on the number of cubic yards of fill excavated in the preceding month (R. 16a-17a). Brewster was under no obligation to purchase a specific quantity of fill. It was not bound to extract the cross-sections of earth designated on the grading plan, whose sole purpose was to ensure that the property be left in a

condition suitable for taxpayers' future use. The purported minimum requirement of 400,000 cubic yards was subject to the conditions that this amount would continue to be required by Brewster's contract with the State and that the fill meet the State qualitative requirements (R. 17a–18a). These aspects of the transaction are strikingly inconsistent with taxpayers' contention of an outright sale "in place."

3. While the decisions of the Second and Ninth Circuits relied on by the taxpayers (Pet. 3–5) hold that there was a sale "in place," they turn upon the particular terms of the contracts. The courts in those cases construed different contract provisions as imposing an absolute obligation upon the purchaser either to take a fixed quantity of material, or to pay a fixed price irrespective of the quantity of material in fact excavated. In *Barker* v. *Commissioner of Internal Revenue*, 250 F. 2d 195, 197 (C.A. 2), in addition to a $10,000 advance deposit, the contractor was compelled to pay no less than $3,000 quarterly "regardless of the amount of material actually taken." Similarly, in *Gowans* v. *Commissioner of Internal Revenue*, 246 F. 2d 448 (C.A. 9), the court held that the owner of the land retained no economic interest in the "black sand" to be removed since the agreement provided for the removal of all the sand at a given unit price.

The question whether the decision below conflicts with *Crowell Land & Mineral Corp.* v. *Commissioner of Internal Revenue*, 242 F. 2d 864 (C.A. 5), is more difficult. There, the contract provided that the taxpayer "as *vendor* * * * *sold and conveyed* * * *

with full warranty of title, all sand and gravel underlying certain described property" (emphasis in original). *Id.* at 865. On the other hand, the contract provided for a fixed price per cubic yard, and all the sand and gravel not removed by the vendee after five years reverted to the vendor. Therefore, it appears that there was not in reality a sale of a fixed quantity of material. Nonetheless, the Fifth Circuit held that all the sand and gravel were sold, and concluded that the payment constituted capital gain. While we believe that the Fifth Circuit misconstrued the contract, if this construction is accepted, its decision is not in conflict with the decision below, since here no fixed quantity of material was sold.

The taxpayers primarily rely for a showing of conflict (Pet. 3–5) on *Linehan* v. *Commissioner of Internal Revenue*, 297 F. 2d 276 (C.A. 1). The First Circuit, while acknowledging the validity of the "economic interest" test, thought that the taxpayer there had not retained such an interest because "in every instance he sold sand and gravel for fixed prices per cubic yard without reference to the prices received or the profits, if any, made by the exploiters." *Id.* at 279. In the instant case, the Third Circuit did not agree that a fixed price was conclusive evidence of a lack of an economic interest and thought, with petitioners, that its decision placed it in conflict with *Linehan* (Pet. App. 11a, note 4).[3]

The decision in *Linehan* is not, however, in conflict

[3] We have dealt above with the similar belief of the Third Circuit that its decision conflicted with that of the Fifth Circuit in *Crowell Land and Mineral Corp., supra.*

with the actual result in this case, for the situation here differs in a very material respect not relied upon by the court below. *Lindsay*, and the other cases relied on by the taxpayers, involved the sale of a depletable asset, sand and gravel, which was entitled to a percentage depletion allowance (26 U.S.C. 613) and which was severable from the real property remaining to the taxpayer. On the other hand, common dirt is available in almost unlimited quantities and is saleable only when it is the most convenient source of borrow. Only rarely would value be separately assigned to dirt when land is acquired and its disposition (as in this case) does not normally diminish the value of the remaining land.

To qualify for capital gains treatment, the taxpayer must establish that the property disposed of constitutes a recognizable capital asset. Thus, the contract of disposition or other evidence must establish with greater precision than in the case of identifiable minerals just what it is that the taxpayer claims to have parted with.[4] Unless the owner can establish that a specific asset was conveyed, he is in essentially the same position as a licensor who has allowed the use of his property for consideration or a joint venturer who has agreed to supply fill for a construction project.

[4] This is not to say that capital gains treatment is never proper on the sale of dirt. See *Dann* v. *Commissioner*, 30 T.C. 499, where capital gains treatment was allowed on a finding that the amount of dirt required to be taken was clearly specified, the dirt was sold at a fixed price per unit taken, and the land remaining thereafter was devoid of useful value.

As we have noted, the *Linchan* case involved a depletable mineral, not dirt, and, consequently, it is not in conflict with the decision below. Nor is any other case in conflict. Indeed, as far as we have been able to ascertain, this is the only case involving dirt which has been decided by a court of appeals. We believe that the issues in this case—which involve complex and far-reaching concepts—should be thoroughly considered by other courts of appeals before review is appropriate in this Court.

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be denied.

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